

**COMPTROLLER OF THE CURRENCY  
PRECEDENTS AND OPINIONS ON Section 9.18**

**Admissions and Withdrawals**

**9.5000.12 CFR 9.18(b)(1)** requires that all admissions and withdrawals be completed and posted to the appropriate ledgers within 10 business days of the valuation date.

**9.5010.** The charging of an admission fee is not permitted in a collective investment fund. The charging of a withdrawal fee is also prohibited.

**9.501 1.** The investment of new funds benefit each participating unit on a pro-rata basis, and therefore the expense of purchasing investments with new money should be borne on a pro-rata basis. 12 CFR 9.18(b)(3) provides that all participations in the collective investment fund shall be on the basis of a proportionate interest in all of the assets. Therefore, admissions must be based only on the market value of the fund.

**9.5015.** Charging of the cost of selling property to satisfy a withdrawal to the withdrawing participants is inequitable. Such cost must be properly borne by the entire fund.

**9.5020.** A bank as trustee may not restrict a withdrawal to any specific percentage, either of a participant's holdings or of the market value of the fund. Such limitations are not consistent with the operation of a collective investment fund. In a 9.18(a)(1) fund, the establishment of a date prior to the valuation date by which all notices for admissions and withdrawals must be received is contrary to 12 CFR 9.18(b)(4), which requires all requested to be accepted if received on or before the valuation date. However, a 9.18(a)(2) fund may have a prior notice requirement, provided it does not exceed five days.

**9.5030.** Common trust fund units may be transferred from one trust to another where the beneficiaries remain the same. The OCC; cannot pass upon the tax consequences of such a transfer.

**9.5035.** There is no provision in 12 CFR 9 that would prevent an annual distribution of realized capital gains. Such distributions should be made to all participating accounts.

**Termination .. Merger**

**9.5050.** In order to terminate an existing collective investment fund, the board of directors must pass a resolution approving the action, and a final audit should be performed as of the date of termination. The OCC should be notified of the termination.

**9.5060.** The OCC does not object to the merger of two common trust funds provided the merger is in the best interest of the participants and does not result in adverse tax consequences. A final audit of a fund should be conducted prior to its merger with the surviving fund. Prior OCC approval of the resulting common trust fund is not required.

9.5063. The OCC ordinarily will not object to the merger of common trust funds maintained by two banks, both of which are members of the same affiliated group, provided the degree of common ownership is within the standards established by 26 USC 1504.

9.5100. Within 90 days after the end of a fund's fiscal year, the bank administering the fund must prepare a financial report of the fund as required by Section 9.18(b)(5)(ii).

9.5110. The OCC has authorized comparisons of fund performance with that of general market indices, such as the Dow Jones and the Standard and Poor's 500, to be included in the annual report. We feel that this will assist the customer in evaluating the results. Such authorization would not permit comparisons with other bank's funds or with mutual funds, nor predictions of future investment performance.

9.5111. For certain purposes, a bank may use excerpts or summaries of the information contained in the financial report. Such excerpts should not be misleading. When excerpts or summaries are used, the material should indicate that a copy of the complete financial report of the common trust fund is available and will be furnished upon request.

9.5112. Information concerning common trust funds may be given to prospective customers if the solicitation is a bona fide promotion of the services offered by the trust department and not actually a promotion of its common funds. Prospective customers may be defined to include present commercial customers of the bank, shareholders of the bank, and those individuals expressing an interest in establishing a fiduciary relationship with the bank. Prospective customers would not be so broadly defined as to include any resident of the service area of the bank. Mailing the financial report or summary of the financial report to any resident of the service area would be considered marketing the common trust fund.

9.5113. Copies of a common trust fund financial report may be furnished to prospective customers by use of displays in the bank's lobby or by direct mailing to those persons who have a legitimate interest in the fund, such as stockholders. All other references to the common trust fund may only be made as part of an advertisement for the bank's general trust services. Materials limited exclusively to the promotion of a common trust fund are prohibited.

9.5114. The financial report of a common trust fund may contain information in addition to that specified in 12 CFR 9.18(b)(5)(ii) and (iii). For example, prospective customers may be provided with brochures which describe the administration, operation, and investment objectives of the funds maintained by the bank.

9.5118. No advertisement restrictions have been placed on banks with respect to 9.18(a)(2) funds. The OCC does, however, monitor advertisements for any violations of the antifraud provisions of the securities laws. With respect to advertising of 9.18(a)(2) funds, the bank should conform to the standards of the SEC and the NASD in order to avoid securities laws violations.

#### **Exchange of Assets for Units**

9.5200. While participations in collective investment funds operated under Section 9.18(a)(2) may be purchased in kind with securities or other assets by eligible trusts, participations in funds operated under Section 9.18(a)(1) may only be purchased for eligible fiduciary accounts with cash, with one exception. Participations in these funds may only be purchased with certain nonmarketable government obligations.

It is permissible, under Section 9.12(d), where fair to both accounts, to sell assets of a participating account to a collective investment fund for cash. If it is desired also to obtain participations in that fund for the selling account, they may be obtained with cash at the next valuation date. However, there must be two distinct and valid transactions.

#### Accounting .. Income and Expenses

9.5250. It is not equitable to participants entering or withdrawing from the collective investment fund to credit income to the fund when received rather than when declared. Similarly, debiting the fund for certain expenses when paid rather than accruing them may not be equitable to all participants. Cash basis accounting deprives participants of income to which they have legal title and may charge them with a disproportionate share of expenses.

9.5255. Late charges collected on notes and mortgages held in collective investment funds should be deposited to the account of the collective investment fund, not to the bank's income account. The collective investment fund participants, not the bank, have been deprived of time income due to late payment.

#### Expenses and Fees

9.5300. In order to conform properly to the requirements of Section 9.18 of 12 CFR 9 and the rules and regulations of the OCC, the following will establish the proper handling of all expenses incurred in the administration and operation of a collective investment fund:

(a) Expenses may be charged to (1) the principal or income account for the reasonable cost of audit performed by independent public accountants, but shall not include the cost of audit by auditors of the bank; (2) the income account if a charge is made for the reasonable expense incurred in servicing mortgages held in a collective investment fund; (3) the principal or income account whichever is applicable, for all costs, commissions, taxes, transfer taxes, legal fees and other expenses associated with the purchase or sale of assets of a collective investment fund; and (4) the principal and income account, whichever is applicable for a management fee, provided the fee charged to the fund and the fee charged to the participating trusts, if any, should not exceed the fee which would be paid by such participating accounts if they were not invested in the collective investment fund.

(b) Expenses that may not be charged against the fund but shall be absorbed by the bank are the cost of establishing or reorganizing a collective investment fund and the cost of printing, publishing and distributing the full financial report.

(c) The preceding is not intended to be all inclusive or preclude consideration of specific fact situations or legal requirements peculiar to particular jurisdictions. For example, it would be permissible to charge to principal or income of a collective investment fund for the cost of court accountings where such are required by law. The payment of state personal property taxes imposed upon securities held in a common trust fund is also a proper charge to the income cash of the fund and need not be allocated among the participations.

9.5305. It is not permissible to engage a CPA firm to audit a collective investment fund which also performs the valuations. Independence of the CPA is impaired since this practice places the accounting firm in the position of reviewing its own work. Further, while the cost of a CPA audit may be charged to a collective investment fund, the cost of valuation is a cost of operating the funds which must be borne by the trustee bank. Therefore, the audit fee may not be increased because a CPA firm is performing the valuation.

9.5310. When a plan is amended and restated for reasons not within the control of the bank, it is our opinion that these expenses should be paid by the bank. The costs of maintaining the plan in conformity with law and regulation is a cost of establishing the fund. Also since the amended plan will be of continuing benefit, it would not be equitable to charge only the present participants.

9.5315. The OCC ordinarily does not object to charging a collective investment fund for real estate commission expense, provided it is reasonable.

9.5317. A bank, in the operation of a collective investment fund, may employ an investment advisor, but the use of such an advisor may not result in additional expenses to the fund or its participants. Such advisors may only make recommendations; the decision process must remain with the trustee bank.

9.5320. A bank, in the operation of a collective fund, may employ an affiliate to perform services for the collective fund. Such affiliate may only engage in those activities that the bank as trustee could perform. The employment of an affiliate may not result in additional expenses to the fund or its participants. The affiliate would be subject to 12 CFR 9 and the full jurisdiction of this Office. When a bank contracts with an affiliate, there should be in effect an agreement between the bank as trustee of the collective fund and the affiliate governing the provision of such services to the fund.

#### Own Bank Obligations

9.5355. Sections 9.12 and 9.18(b)(8)(i) of 12 CFR 9 preclude the trustee of a collective investment fund from making any investments, temporary or permanent, in repurchase agreements between a fund and the commercial banking department of the bank or its affiliates.

9.5360. The Comptroller of the Currency has permitted a collective investment fund established either under 12 CFR 9.18(a)(1) or (a)(2) to invest primarily in certificates of deposit of the trustee bank, if such certificates are of a short term and trust accounts are invested in the fund temporarily pending permanent investment or distribution. Unless the fund qualifies as a STIF as defined in Precedent and Opinion 9.5900, assets of the funds must be marked to market or valued on a fair basis as determined in good faith by the trustee.

#### Creditor Relationships

9.5400. Pursuant to Section 9.18(b)(8)(i)(b) of 12 CFR 9, a national bank is prohibited from making any loan on the security of a participation in a collective investment fund, regardless of the capacity in which the bank is acting for the participating account. The fact that the bank would charge a reasonable rate of interest on the loan is irrelevant.

9.5405. The fact that a trust account holds a participation in a collective investment fund would not prohibit the obtaining of an unsecured loan by that trust from the commercial department, provided the loan was amply protected by other assets of the account.

9.5410. It is not permissible for the trustee of a collective investment fund to borrow monies and/or pledge the assets of the fund except to protect the assets of a liquidating or segregated account or to create temporary cash overdrafts as provided by paragraph 9.6910.

## Liquidity and Investment Limitations

**9.5500.** In regard to the application of the 10 percent limitation of Section 9.18(b)(9)(i) of 12 CFR 9 for participation in a collective investment fund:

- a. Where a person is entitled to more than 50 percent of the income from two or more trusts, the participations held by these trusts are combined for the purpose of the above limitation if the trusts were created by the same person or persons.
- b. Where a person is entitled to receive as much as one-half or more of the income from a trust and also may receive one-half or more of the income or principal, in the discretion of the trustee, from another trust created by the same person or persons, the participations of these trusts would be subject to the limitations.
- c. Where two trusts created by the same person or persons have the same remainderman but different income beneficiaries, the 10 percent limitation would not apply.

**9.5505.** It is the opinion of this Office that the investment of a collective investment fund in shares of a money market fund, assets of which are limited to U.S. Government obligations, would not be the functional equivalent of an investment by the collective investment fund directly in obligations of the U.S. Government. The limitations of 9.18(b)(9)(ii) would therefore apply to investments in such a money market fund.

When a bank buys U.S. Treasury obligations directly, it expects to receive a return on those obligations based on their face value and stated interest rates. The bank relies on its active management of the securities, when such management is appropriate, to maintain stability of income for the collective investment funds. Conversely, when a bank purchases fund shares, its ultimate return or yield is not solely dependent on the credit of the U.S. Treasury. The bank expects to receive profits primarily through the management efforts and expertise of the fund manager.

**9.5510.** If a fund has over 10 percent of a particular asset as a result of outright investments therein, this must be corrected by the next valuation date. If an asset becomes in excess of 10 percent of the market value of the fund for any other reason, such as through its market value appreciating faster than the rest of the portfolio, there is no requirement for a cut-back until the asset becomes in excess of 15 percent of the fund and remains in excess of 15 percent on each consecutive valuation date for six months. At this point the bank has one year to cut the asset back to 10 percent of the fund.

**9.5512.** If a participation becomes in excess of 10 percent due to direct investment, it should be reduced at the next valuation date to the 10 percent limitation. If a participation becomes in excess of 15 percent for any other reason the reduction to 10 percent should be made within one year.

**9.5515.** Pursuant to Section 9.18(b)(9)(ii) of 12 CFR 9, the 10 percent limitation applies to all investments, both temporary and permanent, except direct obligations of the United States or other obligations fully guaranteed by the United States as to principal and interest.

**9.5520.** The 10 percent rule stated in Section 9.18(b)(9)(ii) of 12 CFR 9 is separately applicable to a state and to each city, county, special district or other local governmental entity of that state. As long as there is not a direct or indirect guarantee of the repayment of the obligations of the local governmental unit by the state itself, the obligations of such units will not be aggregated with those of the state or with one another in applying the 10 percent rule.

**9.5525. (Rescinded.)**

**9.5530.** Under 12 CFR 9, a collective investment fund is required to maintain at least 40 percent of its funds in cash or readily-marketable securities. In order for a mortgage to be classed as readily-marketable, it must be insured by the Federal Housing Administration or guaranteed by the Veterans Administration. Therefore, a fund containing 40 percent in cash and FHA or VA mortgages and 60 percent in conventional mortgages would conform to the Regulation.

**9.5535.** For purposes of the marketability requirements of 12 CFR 9.18(b)(9)(iii), investments in certificates of deposit, time deposit open accounts, and other similar instruments would not be considered readily marketable unless they can be readily sold in a secondary market or unless they have reached their maturity date and can be considered cash.

## **Mortgages**

**9.5700.** A simplified procedure for the handling of mortgage loan investments in collective investment funds operated by national banks has been approved by the OCC. Its primary purpose is to relieve the bank of costly bookkeeping and processing details by permitting it to utilize for this purpose the facilities of an organization especially established to handle mortgage loans. Under this procedure, a national bank may enter into a formal arrangement with a mortgage banking firm whereby the latter originates mortgage loans and offers them to the bank's trust department for placement in a collective investment fund in groups of such size as may be agreed upon. The bank may purchase all or such portions of the offered loans as it desires. The actual notes must be held by the bank but the mortgage banking firm may retain all supporting records, and receive payments and remit therefore. It must furnish not less often than monthly a detailed statement showing principal payments, interest payments, or other credits or charges, balances due and any other pertinent information on the individual loans comprising the group. The mortgage banking firm must advise the bank not less often than monthly of defaults in payments on loans, delinquencies in payments of taxes, insurance, etc., and must act to adjust such matters as instructed by the bank. The bank must retain the right to sell any specified mortgage note or notes out of a particular group at any time. The arrangement between the bank and the mortgage banking firm must contain a binding commitment on the part of the latter to repurchase at no loss to the bank any notes later found not to be as represented. The agreement must also specify that all records and documentation in possession of the mortgage banking firm relative to notes owned by the bank are to be subject to inspection during normal business hours by the bank, its auditors and examiners of the OCC.

Entries on the trust department records relative to notes held under the above-outlined procedure may be in gross rather than in detail, in which case the bank must maintain periodic statements from the mortgage banking firm as subsidiary information supporting the entries.

**9.5710.** A bank may establish and maintain a collective investment fund, the investments of which shall consist exclusively of mortgages. Such a fund must comply with the marketability requirements of Section 9.18(b)(9)(iii) of 12 CFR 9.

**9.5720.** A national bank's trust department may enter into a purchase agreement with respect to mortgages of a common trust fund with an established firm of unquestioned financial resources as a satisfactory arrangement for meeting marketability requirements. It would be improper for the trust department to enter into such an agreement with the bank.

9.5725. We do not object to the valuation of real estate mortgage loans at the unpaid balance if that figure is a fair approximation of market value. When more than 10 percent of the fund is composed of real estate loans, conventional mortgages should be valued in line with the current money market rate for such obligations and VA and FHA mortgages should be priced at the current market rate.

9.5730. Section 9.18(b)(10) of 12 CFR 9 provides for the charging of a fee to a collective investment fund for servicing real estate mortgages to be paid "to servicing agents, including the bank administering the fund."

9.5735. The commercial banking department may not share in the origination points received from the borrower upon closing a mortgage to obtain a servicing fee. Sharing points is considered an improper charge for the servicing of mortgages. Further, it is inequitable to the participants inasmuch as it is a one-time expense and not charged during the life of the mortgage.

9.5740. Any mortgage which is in default for the period of 60 days or more should be removed from a fund before admissions or withdrawals are made. However, whenever a mortgage may be said to be only technically in default for reasons which are satisfactory to the bank, and no credit weaknesses other than the reason for the default exists, such investment shall not automatically cease to be eligible. If the loan is not made current before two valuation dates occur, it should be removed from the account. Within this limitation, the Trust Investment Committee could properly be given discretionary authority as to the segregation or sale of such defaulted mortgages.

9.5750. Section 9.18(b)(11) of 12 CFR 9 provides for the establishment of a reserve account from the income of mortgages held in a collective investment fund. This account cannot be used to absorb principal losses; only income in default may be charged to it. In cases of default of principal for other than justifiable reasons for any extended period of time the bank should either segregate the mortgages or sell them. The provisions of 9.18(b)(8)(ii) authorize the purchase of such mortgages in certain circumstances. No other type of reserve may be established. For example, a bank may not set up a reserve for all realized gains and losses.

#### Exclusive Management

9.5770. A bank may employ an agent or use a pricing service to perform the valuation of the collective investment fund. However, the use of either requires the trustee to periodically verify their accuracy or such practice will be deemed to be an undue delegation of fiduciary responsibility.

9.5775. This Office has not permitted a collective investment fund maintained by one trustee to be invested in another collective investment fund maintained by an unrelated trustee. Under the provisions of 12 CFR 9.18(b)(12), a national bank administering a collective investment fund shall have the exclusive management of it. A collective investment fund investing in another collective investment fund maintained and administered by an unrelated trustee would be an improper delegation of investment responsibility.

#### Charitable Trusts

9.5800. Charitable trusts may be collectively invested with other charities and/or with other types of accounts in either Section 9.18(a)(1) or Section 9.18(a)(2) funds. Charities would be most appropriately invested in a 9.18(a)(2) fund. Tax exemption must be obtained in both cases through Section 584 and therefore, participation must be limited to accounts for which the bank acts as trustee or co-trustee. Revenue Ruling 56-267 is not available for funds which include other than employee benefit accounts. As a result, charities held in the capacity of the agent may not be invested in collective funds of any type.

**9.5810.** A trust created for charitable purposes from funds contributed by various donors is a form of collective investment fund subject to Section 9.18 of 12 CFR 9.

Such commingling either within a trust or between trusts created for the same general purpose serves a worthy purpose and there is no apparent need for the safeguards applicable to common trust funds. Therefore, the investments of such accounts may be commingled when not in contravention of local law or governing instruments, and to the extent that such action may result in a form of collective investment within the meaning of Section 9.18 of 12 CFR 9. Pursuant to the provisions of Section 9.18(c)(5), the national banks have been given approval of the OCC to operate such collective investment funds without compliance with the requirements of subsection 9.18(b).

## **SPECIAL INVESTMENT FUNDS**

### **Short-Term Investment Funds**

**9.5900.** Pursuant to 9.18(c)(5) exemptions have been granted to the "current market valuation" requirement of 12 CFR 9 for funds operated for the short-term investments of trust cash. Such "short-term investment funds" (STIF's) must include the following provisions: (1) Investments must be limited largely to bonds, notes or other evidences of indebtedness which are payable on demand (including variable amount notes), or which have a maturity date not exceeding 91 days from the date purchased. However, 20 percent of the value of the fund may be invested in longer term obligations; (2) Principal is to be valued at cost. The difference between cost and anticipated receipt on maturity is accrued on a straight-line basis; (3) Assets of the fund must be held to maturity under usual circumstances; (4) After effecting the entries and withdrawals not less than 40 percent of the value of the remaining assets of the fund must be composed of cash, demand obligations and assets that will mature on the fund's next business day. If plans contain the foregoing, permission to operate the short-term fund has been granted under Section 9.18(c)(5) of 12 CFR 9. A short-term investment fund must meet the requirements of this Opinion. If the short-term investment fund does not meet those requirements, the assets of the fund may not be valued at cost.

**9.5903.** In a short-term investment fund, the valuation process must be completed before the fund opens again for admissions and withdrawals.

**9.5905.** A variable amount note may be used to meet the 40 percent liquidity requirement of a short-term investment fund (STIF). A STIF may invest in excess of 10 percent of the value of the fund in the demand portion of a single variable amount note established under 12 CFR 9.18(c)(2)(ii). However, the trustee should be guided by the standards of prudence and diversification when making an investment which exceeds the 10 percent limitation.

**9.5910.** Annual financial statement for short-term investment funds may differ from those of other collective funds in the following respects:

- a. Assets may be listed showing par values only if cost and par are the same.
- b. All assets of a similar character (C.D.'s, commercial paper Treasury bills, etc.) of a single issuer may be combined for reporting purposes.
- c. The "profit or loss" figures on security sales may be omitted.



## Covered Call Option Funds

9.5920. Each participating account must contain specific Investment authority for Investment in banks Covered Call Option Collective Investment Fund. If the collective investment fund is established under Revenue Ruling 56-267 which requires Incorporation by reference, then the instrument of the participating account does not have to specifically authorize the investment in options.

\* \* \* \* \*

9.5921. Collective investment funds which are authorized to invest in covered call options and related transactions should provide a specific method for valuing options.

\* \* \* \* \*

## Foreign Securities Investment Funds

9.5940. Each participating account must contain specific investment authority to invest in the banks Foreign Security Investment Fund. This requirement is met if the fund is established under Revenue Ruling 56-267 which requires incorporation by reference.

\* \* \* \* \*

9.5941. (Rescinded.)

\* \* \* \* \*

9.5942. If custody of the securities are maintained outside the jurisdiction of the District Court of the United States, the requirements of Regulation Section 2550.404b-1 of ERISA must be met if the custody of the securities are not held in foreign branches of United States chartered banks, then the bonding requirements of Section 412 of ERISA must be met.

9.5943. A management fee may be authorized only if it were charged in lieu of a regular fee which is normally charged to accounts invested in foreign securities.

9.5944. All other requirements of Regulation 9 would be incorporated in the plan, including provisions relating to specific valuation criteria and the ten-day valuation period.

## Real Estate Investment Fund

9.5960. A real estate collective investment fund established under 12 CFR 9.18(a)(2) may authorize a period of time not exceeding one year for prior notice of withdrawals. If the prior notice period exceeds 90 days no more than 10 percent of the participating account's assets may be invested in real estate collective investment fund.

9.5961. Real Estate held in collective investment fund must be valued at market based on an appraisal not older than one year.

9.5963. The OCC does not object to a real estate collective investment fund borrowing to purchase real estate.

## **Index Collective Investment Funds**

**9.5980.** Index collective investment funds may not invest in own bank securities or securities of the holding company with which the bank is affiliated.

### **9.18(a)(1) Funds**

**9.6000.** Funds operated pursuant to Section 9.18(a)(1) are granted tax exempt status by Section 584 of the Internal Revenue Code. Participation is therefore limited to monies held in the capacity of trustee, executor, administrator, guardian and custodian under Gifts to Minors Act. Accounts in all other capacities including agencies and custodians are precluded from participation.

**9.6010.** New funds may be granted exemptions for their first year of operation from the requirements of 9.18(b)(9), if such exemption is specifically requested of the Washington office.

**9.6020.** Common trust funds should be given generic names such as Equity Fund or Income Fund, so that they do not give the appearance of being merchandised in the manner of mutual funds.

**9.6021.** If a nongeneric name is given to a collective investment fund, the name should accurately reflect the type of investments the fund may engage in and accurately describe the fund's investment policies.

### **9.18(a)(2) Funds**

**9.6100.** Funds operated pursuant to Section 9.18(a)(2) may receive tax exemption pursuant to Section 584 of the IRS Code or Revenue Ruling 527. 9.18(a)(2) funds are limited to tax exempt accounts, and by Section 584 to accounts for which the bank acts as trustee, executor, administrator or guardian. Funds granted exemption by Ruling 56-267 are not limited to these capacities and may therefore include agency accounts. However, any account participating in a fund granted exemption under Ruling 56-267 must also incorporate by reference the terms of the fund plan in its governing instrument. Every employee benefit account is also required by ERISA to authorize participation in any collective fund operated by a bank.

**9.6105.** Collective investment funds for pension and profit sharing trusts may invest in private placements. The investment of collective investment fund assets in private placements would not be imprudent per se. 12 CFR 9.18(b)(1) states that "The plan shall contain appropriate provisions not inconsistent with the rules and regulations of the Comptroller of the Currency as to the manner in which the fund is to be operated, including provisions relating to the investment powers and general statement of the investment policy of the bank with respect to the fund;". The Investment powers clause of the collective investment fund agreement should state the authorized investments of the fund, with a specific provision for any unusual investments. Since private placements are considered an unusual investment, they should be specifically stated in the investment powers clause. A general reference to bonds, notes, debentures or other evidences of indebtedness would not be sufficient.

### **9.18(c)(1) Funds**

**9.6200.** The means of collective investment authorized by Section 9.18(c)(1) is, as is stated in the Regulation, commonly known as a "bank fiduciary fund." Such a fund must be established pursuant to the explicit authority of a statute such as exists in New York. Only a few states have such statutes. No other type of mutual investment company will qualify.

#### 9.18(c)(2)(i) Funds

9.6250. Section 9.18(c)(2)(i) authorizes two or more fiduciary accounts to participate in a single asset. If several fiduciary accounts have an interest in several U.S. Treasury bills or a pool of commercial paper, such an arrangement must be operated pursuant to a formal collective investment plan.

#### 9.18(c)(2)(ii) Funds

9.6300. The OCC has approved a procedure whereby cash held for various fiduciary accounts may be invested on a short-term basis in a variable amount note of a single borrower of prime credit by a national bank. Participating accounts are thus provided with a readily accessible medium for short-term investment of their cash balances.

Under this arrangement, the borrower delivers the note to evidence the amount of the loan outstanding from time to time. The note may be a demand obligation or have a fixed maturity (in which case it is understood that the borrower will renew the note at maturity) and may set forth provisions concerning the rate and payment of interest in the note or in a separate agreement to which reference is made in the note. The note must be payable to the order of the bank or to a nominee of the bank and may be repayable by the borrower in whole or in part at any time, and should contain columns for entering changes in the amount of the loan outstanding, the dates of such changes, and the initial of an employee of the bank authorized by the borrower to make such entries. While it is preferable that all entries affecting the balance of the note shall be recorded thereon, it is satisfactory for such entries to be recorded separately, provided adequate documentation is maintained in regard to all such entries. All notes must be kept in the custody of duly authorized employees of the bank as required by Section 9.13(a) of 12CFR 9 unless an exemption is granted by the OCC.

The amount of the loan may be subject to daily fluctuations as the participants increase or decrease their participations. The net amount of any such increase or decrease depends initially upon the particular requirements of the participants. If it is desired to participate an account in the loan or to increase its existing participation therein, a "buy" order is prepared for the dollar amount of the planned participation. If it is desired to reduce or withdraw an account's participation, a "sell" order is prepared. All buy and sell orders must be combined at the end of each day's business when the net amount of any proposed increase or decrease in the loan is determined. On the following business day, this net figure must be communicated to the borrower by telephone. If the figure indicates a proposed increase in the loan, this communication is an offer to lend the amount of the increase which the borrower may either accept in whole or in part, or reject. If the figure indicates a proposed reduction in the loan, communication of that fact constitutes a demand for payment of the amount of the reduction. The resulting increase or decrease in the loan and the new balance due must be then recorded by making appropriate entries on the note. The balance so entered, when confirmed by the borrower in writing, should be understood to constitute conclusive evidence of the balance owing on the loan. The net amount of any increase (or decrease) in the loan must be promptly credited to (or charged against) the borrower's account with the bank. Interest must be paid monthly on the daily amount of the loan outstanding during the preceding month at a rate which is mutually agreed upon by the bank and the borrower and specified in the note or related agreement.

Participants of each account in the loan must be reflected in the securities record of each account in the bank's trust department. A participation record for each account must also be maintained and a check must be made each time a change in the amount of the loan occurs to assure that these participation records are in balance with the outstanding amount of the note.

Broad investment power in the governing instrument is sufficient authority for engaging in this type of investment. The bank may not participate in the loan for its own account nor may it acquire such a participation. Neither may it agree that the note will not be reduced below a given figure.

**9.6302.** Trust department funds may be placed in variable amount notes for periods of up to one year without violating the short-term restriction of 12 CFR 9.18(c)(2)(ii). If circumstances justify the investment periods, funds may be held for over one year. For example, funds may be held over one year pending payment of estate taxes.

**9.6305.** Custodial and agency accounts may be invested in variable amount notes, provided that this does not violate the terms of the note.

**9.6308.** If agency accounts are invested in a variable amount note and the bank does not have investment authority under the agency agreement, it must obtain a letter of direction from the principal for each purchase and sale of an interest in a note. Although accounts for which the bank does not have full investment responsibility may invest in the note, the bank may not market participations in the note.

**9.6310.** Section 9.18(c)(2)(ii) of 12 CFR 9 requires that variable amount note obligors be prime credit borrowers with whom no conflict of interest exists. A prime credit borrower is one which has commercial paper or debt obligations outstanding which are rated in one of the two highest categories by at least two nationally recognized rating services. However the corporate trustee cannot rely solely upon a determination by the rating services that a borrower is a prime credit, and therefore it should perform an independent credit analysis of the company to ensure the quality and safety of the investment. Variable amount notes should be limited to obligors that are national concerns with a broad base and diversified operation.

**9.6311.** A company that is not rated may not be considered a prime credit for purposes of 12 CFR 18(c)(ii). Since the ability of a borrower to obtain long-term financing provides a means of meeting its variable amount note obligation independent objective ratings are important in determining the credit worthiness of a corporation.

**9.6330.** A national bank may not accept participations in its variable amount note from other banks.

**9.6335.** Fiduciary accounts of a national bank may participate in a variable amount note operated by an affiliate bank if specific approval to do so is granted by the OCC.

**9.6340.** It is improper for a national bank to take a participation in variable amount notes as security for a loan to its fiduciary accounts.

**9.6345.** No fee may be charged to any fiduciary account for participation in a variable amount note unless fees are uniformly charged for all types of temporary investment.

### **9.18(c)(3) Funds**

**9.6400.** Section 9.18(c)(3) of 12 CFR 9 provides a means of collective investment for banks having a small number of fiduciary accounts without subjection to the requirements applicable to other common trust funds. Such a fund may be operated so long as the total investment on the part of any one account participant does not exceed \$10,000. This device is available until such time as a sufficient number of accounts permits the operation of a common fund subject to the provisions of Section 9.18(b) of 12 CFR 9.

**9.6410.** Agency accounts are not eligible for participation in common trust funds operated under Section 9.18(c)(3) of 12 CFR 9. Participation in such funds is limited to the capacities which are specifically enumerated in Section 584 of the Internal Revenue Code of 1954.

#### **9.18(c)(4) Funds**

**9.6500.** A trust created by a company and its subsidiaries or closely-related corporations, the assets of which are invested in a single portfolio, constitutes a form of collective investment. Such funds, however, are granted an exemption under Section 9.18(c)(4) of 12 CFR 9 and may thus be commingled without compliance with Section 9.18(b). Other closely-related or subsidiary companies of the original settlor may subsequently join the fund.

The relationship among the several settlors of such a trust must be substantial. In all cases where the affiliation or close relationship is not based upon at least a 50 percent stock ownership, it would be a question of fact to be decided by the OCC as to whether the relationship qualifies for this section. We do not believe, for instance, that plans established for the collective investment of monies contributed by separate businesses, even if limited to participants engaged in the same field or profession, have the requisite close relationship among settlors upon which a qualification under (c)(4) may be justified.

#### **9.18(c)(5) Funds**

**9.6600.** 12 CFR 9 provides, in Section 9.18(c)(5), a means to make application to the OCC for permission to operate collective investment funds without compliance with some or all of the provisions otherwise applicable to collective funds. In meritorious cases approval will be given. For example, permission was recently given to a small bank to operate a special collective investment fund for cemetery trusts with annual valuation dates, as long as no contributing trust exceeded \$1,000 in amount.

#### **Multi-Bank Common Trust Funds**

**9.6700.** In the absence of permissible state law, the use of another bank's common trust fund may be considered an unauthorized delegation of investment responsibility. However, if state law permits the establishment of common trust funds for affiliated banks, authorized accounts may participate in the collective funds maintained by affiliates. The degree of affiliation required is defined in 26 USC 1504.

**9.6705.** To effect affiliate participations, the common trust fund plan should specifically authorize its use by fiduciary accounts of affiliated banks. The board of directors of the affiliated bank should also authorize the use of the common trust fund maintained by its affiliate. The investment committee minutes of the affiliated bank administering the participating account should document the portfolio management decision regarding admission/withdrawal from the multi-bank common trust fund. The bank maintaining the common trust and should be notified on or before the fund valuation date, and the appropriate trust department committee should approve such affiliate bank admissions/withdrawals as required by 12 CFR 9.18(b)(4).

**9.6715.** The trustee of a multi-bank common trust fund must comply with 12 CFR 9.18(b)(5)(iv). The host bank may furnish the financial report or notice of its availability through an affiliated bank, but this responsibility may not be delegated to an affiliated bank in the plan of operation.

## Miscellaneous

9.6900. In the distribution of income of a collective investment fund, the principal cash of such a fund may be used, provided that all income received thereafter shall be applied against this advance until it is eliminated. In no case shall a distribution of income be made which exceeds the total principal cash and income cash then on hand.

9.6910. National banks operating collective investment funds under Section 9.18 of 12 CFR 9 may immediately invest funds committed to collective investment upon the following conditions even though such investment technically creates an overdraft in the fund: (1) Such investments may not exceed that net cash available to such a fund on the day following a valuation date set forth in the governing instrument; therefore, any overdraft in the fund so created must not exceed the recorded amount of total monies committed for participating accounts less the estimated dollar amount awaiting withdrawal from the fund; (2) the monies committed from any participating account must not as of the date of the commitment or at any time subsequent but prior to the execution thereof exceed the amount of investable cash on hand in the account plus any amount due from the sale of assets; and (3) except for the receipt of proceeds from sales, the technical overdraft created in the fund must be eliminated not later than the computation period provided for valuation of the fund or 10 business days, whichever is earlier.

9.6920. A common trust fund administered within a trust department may hold units of another common trust fund established in the same department in such cases, the funds are exempt from the 10 percent limitations of 12 CFR 9.18(b)(9).

9.6930. There is no Internal Revenue Code requirement that a letter of determination be obtained for a collective investment fund. However, by custom, the bank establishing the collective investment fund or the attorney drafting the plan obtains a written opinion from the Internal Revenue Service that the plan qualifies under the Code and is exempt from income tax. These opinions are obtained in order to assure that the document is properly drafted and that the collective investment fund is exempt from income tax. If the collective trust itself is not exempt from income tax, it may affect the tax exempt status of the accounts investing in the fund.